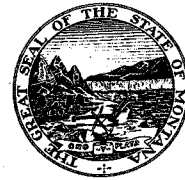




Dan Bucks  
Director

# Montana Department of Revenue



Brian Schweitzer  
Governor

To: Rep. Jack Wells  
From: ~~D~~an Dodds, Senior Tax Policy Analyst  
Date: March 14, 2007  
Subject: HB 637 Fiscal Note

EXHIBIT 21  
DATE 3-13-07 Am  
HB 637

One of the witnesses in the hearing on this bill, Roger Hagan, presented an estimate of the annual fiscal impact that is smaller than the estimate in the fiscal note. Mr. Hagan's estimate used a lower tax rate and lower salary figures. This memo explains the differences.

## Tax Rate

Most members of the National Guard and Reserve have other jobs and income. If their military salaries are exempted from state tax, they will continue to pay tax on their other incomes. The difference in tax is the difference in salary multiplied by the marginal tax rate. The marginal tax rate is the rate from the rate table that is applied to an additional dollar of income. The fiscal note used the actual average marginal tax rate from 2005 full year resident returns, 5.44%.

The 3.98% rate Mr. Hagan used is the average effective rate reported in the department's Biennial Report. The average effective rate is tax divided by adjusted gross income. The average effective rate is always lower than the marginal rate because the marginal rate rises with income and because the average effective rate is based on gross income before deductions and exemptions are subtracted to give taxable income.

The average effective rate would be the correct rate to use to calculate the impact of exempting all income of a group of taxpayers. For a proposal to exempt a portion of income, such as HB 637, the marginal rate should be used.

## National Guard Salary

Mr. Hagan estimated the National Guard salaries that HB 637 would exempt to be \$31.3 million by multiplying estimates of the number of Guard and Reserve members by estimates of average daily salary and average annual days of duty.

The fiscal note used actual 2006 Montana National Guard payroll of \$33.7 million, which is slightly higher than Mr. Hagan's estimate.

### Reserve Salary

In preparing the fiscal note, I was able to obtain the number of reservists but not payroll. I assumed the same average annual salary as for National Guard members, and estimated annual payroll of \$9.3 million.

Mr. Hagan used lower estimates of both the number of reservists and average annual salary to get estimated annual payroll of \$5.85 million.

Both numbers are estimates, and it is not clear which is the better estimate. Using Mr. Hagan's estimate would reduce the annual fiscal impact by \$188,000 ( $5.44\% \times \$3.45$  million).

# House Bill 637 - Fiscal Impact Estimate

Provided By: Montana National Guard Association/Enlisted Association of the National Guard of Montana

## Prepared For: Representative Harry Klock

Service and Duty Type	Number of Members	Average Daily or Annual Salary	Average Annual Duty Days	Total Taxable Earnings	Income Tax Revenue (2005 Average Marginal Tax Rate Per DOR - 3.98%)	Remarks
National Guard (Traditional)	3,540 - 346 AGR's = 3,194	\$90	65	\$18,684,900	\$743,659	Approximate end strength
Reserve (Traditional)	1,100 - 100 AGR's = 1,000	\$90	65	\$5,850,000	\$232,830	Estimated End Strength and AGR's
National Guard (AGR's)	346	\$100	365	\$12,629,000	\$502,634	Actual AGR Count
Reserve (AGR's)	100	\$100	365	\$0	\$0	Current Statute Exempts These Members From State Income Tax
				\$37,163,900	\$1,479,123	
<b>Estimated Annual Fiscal Impact</b>						(\$1,479,123)

### Assumptions:

- 3,540 Montana National Guard members of which 346 are AGR's (Active Guard/Reserve).
- 1,100 Montana Reserve members of which 100 are AGR's (Active Guard/Reserve)
- Average daily taxable military salary for a "traditional" National Guard or Reserve member is \$90. (traditional members perform weekend duty and annual training)
- Average annual number of training days performed by a "traditional" member is 65 days.
- Average annual taxable salary for an AGR member is \$36,500 (\$100 per day).
- Members of the Reserve who are AGR do not pay state income tax under current state statute.
- The Average Effective Tax Rate for 2005 is 3.98% as published in the MT Department of Revenue Biennial Report.

Prepared By: Roger A. Hagan, 1224 Stuart Street, Helena, MT 406-459-0773 (note: this is only an estimate using the above assumptions)